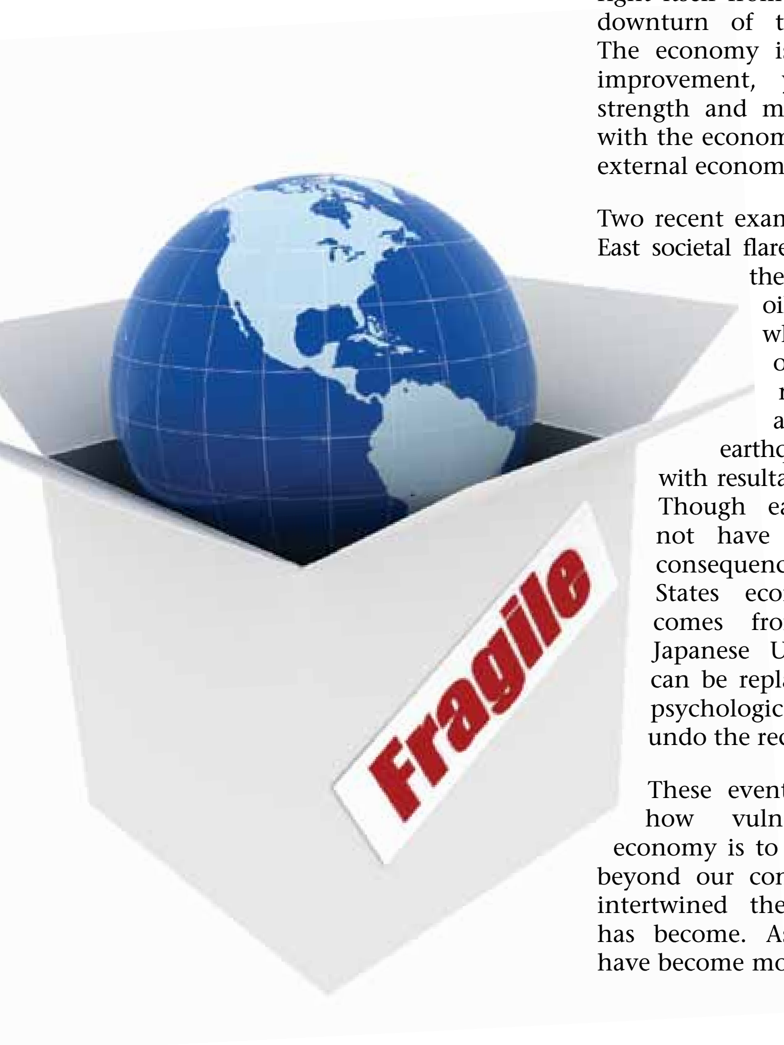
# Threats

## to the Economic Recovery




Recent worldwide events reveal the fragile nature of the economy and the economic recovery. The nation is trying to right itself from its worst economic downturn of the past 70 years. The economy is showing signs of improvement, yet the recovery's strength and maturity are shallow, with the economy still vulnerable to external economic shocks.

Two recent examples are the Middle East societal flare up (highlighted by the disruption of Libyan oil production and what could happen to other oil-producing nations in the area), and the Japanese earthquake and tsunami with resultant nuclear troubles. Though each of these may not have primary economic consequences upon the United States economy—as our oil comes from elsewhere and Japanese U.S. imports/exports can be replaced elsewhere—the psychological effects alone can undo the recovery.

These events expose not only how vulnerable our own economy is to spontaneous events beyond our control, but also how intertwined the world's economy has become. As disruptive events have become more frequent over the past decades (coupled with increased media coverage), consumers have become more reactive to the consequences of these events. It may create a hyper-psychology that leads to strong economic reactions. For example, the stock market took a noticeable hit after the Japanese quake although a more discerning look at the bigger picture probably suggests the economic consequences to the United States will not match the negative consequences suggested by the stock market. The Japanese economy will suffer in the short run (several quarters), but the cleanup operations will actually create an economic stimulus in the long run.

The perception that the stock market gives and what the world events imply, all conspire to weaken consumer confidence. And that is not needed in this nascent and vulnerable phase of economic recovery. Consumers are a major part of the economy and how it performs. Consumer psychology has a direct impact upon the economic performance. There are times when consumer confidence may say one thing and consumer actions say another, but generally, confidence (or lack thereof) does translate into direct consumer response within the economy.

The dshort.com chart shows the flow of consumer sentiment across time. Recessions cause sentiment

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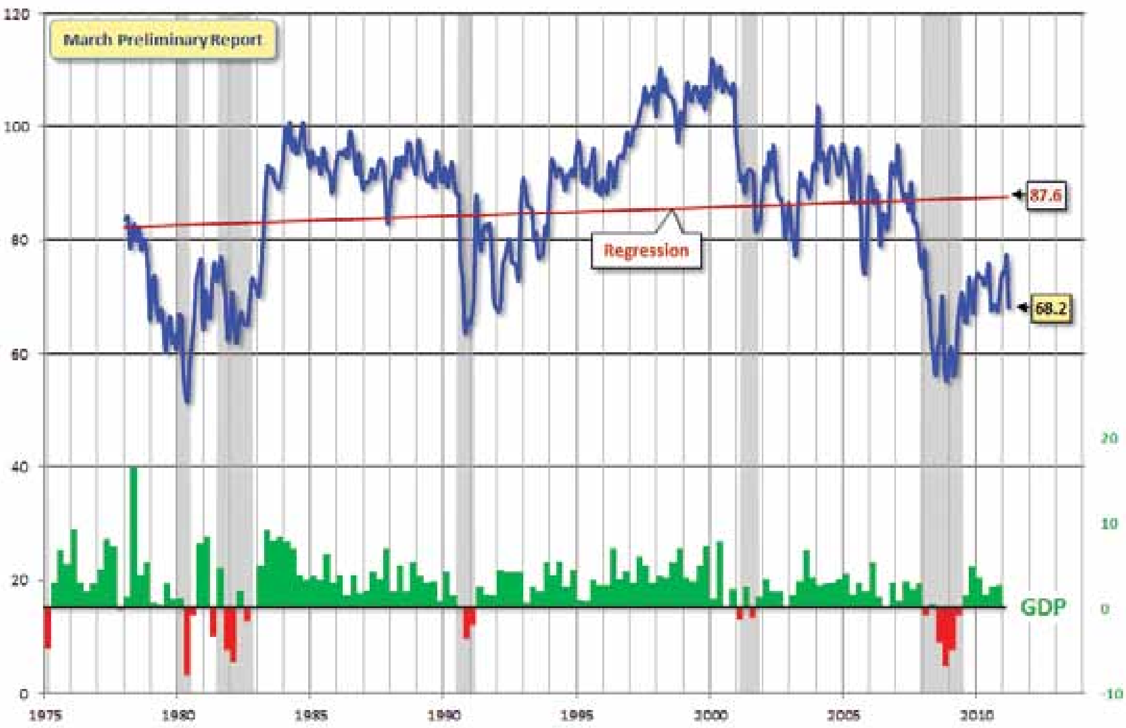
to fall. The current recession has pushed consumer sentiment to its lowest level in 30 years, and it stayed down for the better part of a year. It has since risen, but the increase has not climbed to past levels that imply a strong consumer psychology with the ability to absorb external shocks. In other words, consumer sentiment is still fragile and volatile. Consumer sentiment may yet ride out the current wave of worldwide issues. But any additional bad news, even if small, could be enough to send sentiment falling downward again, and ultimately stalling the recovery.

University of Michigan Consumer Sentiment Index
GDP and Recessions • March 2011 • dshort.com




*Source: dshort.com.*